

BEFORE THE TENNESSEE STATE BOARD OF EQUALIZATION

IN RE: Ridge Mountain, LLC)
Dist. 1, Map 108K, Group A, Control Map 108K,) Hamilton County
Parcel 001)
Commercial Property)
Tax Year 2005)

INITIAL DECISION AND ORDER

Statement of the Case

The subject property is presently valued as follows:

<u>LAND VALUE</u>	<u>IMPROVEMENT VALUE</u>	<u>TOTAL VALUE</u>	<u>ASSESSMENT</u>
\$560,000	\$8,992,000	\$9,552,000	\$3,820,800

An appeal has been filed on behalf of the property owner with the State Board of Equalization. The undersigned administrative judge conducted a hearing in this matter on May 10, 2006 in Chattanooga, Tennessee. In attendance at the hearing were registered agent Walter H. Benedict, Jr., Thomas H. Humphreys, Certified General Appraiser, and Hamilton County Property Assessor's representative Gary Dawn.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Subject property consists of a 280 unit apartment complex situated on a 43.3 acre site at 1185 Mountain Creek Road in Redbank, Tennessee, just north of Chattanooga. Subject complex was constructed in 1986 and contains a total of 22 apartment buildings as well as various amenities.

The taxpayer contended that subject property should be valued at \$7,000,000. In support of this position, the taxpayer introduced an appraisal report prepared by Robert K. Barnes, MAI and Thomas H. Humphreys, Associate Appraiser which valued subject property at \$7,000,000. In addition, Mr. Humphreys was present to testify about the report.

Mr. Humphreys essentially testified that the income and sales comparison approaches support value indications of \$8,100,000 and \$8,200,000 before consideration of deferred maintenance. Mr. Humphreys maintained that the indicated values should be reduced by \$1,200,000 to account for the cost of replacing the masonite siding and miscellaneous repairs.

The assessor contended that subject property should remain valued at \$9,552,000. In support of this position, the income and sales comparison approaches were introduced into evidence. Mr. Dawn asserted that both approaches support the current appraisal of subject property and no allowance is warranted for deferred maintenance.

Since the taxpayer is appealing from the determination of the Hamilton County Board of Equalization, the burden of proof is on the taxpayer. See State Board of Equalization Rule 0600-1-.11(1) and *Big Fork Mining Company v. Tennessee Water Quality Control Board*, 620 S.W.2d 515 (Tenn. App. 1981).

The basis of valuation as stated in Tennessee Code Annotated Section 67-5-601(a) is that "[t]he value of all property shall be ascertained from the evidence of its sound, intrinsic and immediate value, for purposes of sale between a willing seller and a willing buyer without consideration of speculative values . . ."

General appraisal principles require that the market, cost and income approaches to value be used whenever possible. Appraisal Institute, *The Appraisal of Real Estate* at 50 and 62. (12th ed. 2001). However, certain approaches to value may be more meaningful than others with respect to a specific type of property and such is noted in the correlation of value indicators to determine the final value estimate. The value indicators must be judged in three categories: (1) the amount and reliability of the data collected in each approach; (2) the inherent strengths and weaknesses of each approach; and (3) the relevance of each approach to the subject of the appraisal. *Id.* at 597-603.

The value to be determined in the present case is market value. A generally accepted definition of market value for ad valorem tax purposes is that it is the most probable price expressed in terms of money that a property would bring if exposed for sale in the open market in an arm's length transaction between a willing seller and a willing buyer, both of whom are knowledgeable concerning all the uses to which it is adapted and for which it is capable of being used. *Id.* at 21-22.

In view of the definition of market value, the income-producing nature of the subject property and the age of subject property, generally accepted appraising principles would indicate that the market and income approaches have greater relevance and should normally be given greater weight than the cost approach in the correlation of value indicators.

After having reviewed all the evidence in the case, the administrative judge finds that the subject property should be valued at \$9,200,000. As will be discussed below, the administrative judge finds that the various indications of value should be correlated at \$9,200,000. Absent additional evidence, the administrative judge finds that it cannot be determined what, if any, deduction should be made to account for deferred maintenance.

I. Direct Capitalization

For the reasons discussed below, the administrative judge finds that the income approach supports the following valuation of subject property:

Potential Gross Rental Income	\$1,904,400
Less Vacancy & Collection Loss (7%)	- 133,308
Effective Gross Income	\$1,771,092
Plus Other Income	+ 57,132
Total Effective Gross Income	\$1,828,224
Less Operating Expenses & Reserves	- 842,880
Net Operating Income (NOI)	\$ 985,344
NOI Capitalized @ 10.54%	÷ .1054
Indicated Value	\$9,348,615

Despite the fact both appraisers assumed essentially identical estimates of market rent, the most significant difference between their income approaches concerned potential gross rental income.¹ This difference resulted from the fact that Mr. Dawn assumed each unit was rented at the indicated market rent. Mr. Humphreys, in contrast, utilized actual contract rental rates for occupied units and imputed quoted street rents for vacant units.

The administrative judge finds that the Assessment Appeals Commission ruled in *First American National Bank Building Partnership* (Davidson Co., Tax Years 1984-1987) that it “is the entire fee simple unencumbered value and not any lesser or partial interests” which is normally subject to taxations.² Final Decision and Order at 3. The administrative judge finds that for Tennessee ad valorem tax purposes, Mr. Dawn’s methodology should receive greater weight because it reflects a true fee simple valuation. The administrative judge finds that Mr. Humphrey’s approach is more indicative of a leased fee valuation to the extent below market leases are being treated as tantamount to current market rent.

With respect to vacancy and collection loss, the administrative judge finds that the parties’ contended rates of 7.0% (assessor) and 10% (taxpayer) do not differ dramatically and are actually somewhat mutually supportive. The administrative judge finds that Mr. Humphrey’s discussion of this issue at page 90 of his appraisal report indicates a range anywhere from 5%-10% appears defensible. The administrative judge finds the preponderance of the evidence supports Mr. Dawn’s decision to assume a rate closer to the middle of the indicated range.

With respect to other income, the administrative judge finds that Mr. Dawn’s assumption of \$57,132 is actually significantly below Mr. Humphreys’ \$90,000 estimate. The administrative judge finds it appropriate to adopt Mr. Dawn’s somewhat more conservative estimate insofar as the administrative judge previously adopted Mr. Dawn’s estimates of potential gross rental income and vacancy and collection loss.

With respect to expenses, the administrative judge finds that property taxes should be accounted for through the use of an effective tax rate rather than as an expense item. See *Frederick G. Kelsey* (Assessment Appeals Commission) (Montgomery Co., Tax Year 1991). Final Decision and Order at 3. The administrative judge finds that after this adjustment to Mr. Humphreys’ analysis, he assumes expenses and reserves equal to \$842,880. Mr. Dawn, in contrast, assumed expenses (including reserves) of \$803,000. The administrative judge finds Mr. Humphreys more thoroughly substantiated that his assumed expenses are indicative of the market.

¹ Mr. Dawn assumed a potential gross rental income of \$1,904,400. According to the administrative judge’s calculations, Mr. Humphreys potential gross rental income would have equated to \$1,899,960 had he not utilized contract rents for those units currently under lease.

² See also *Hoover v. SBOE*, 579 S.W.2d 192 (Tenn. Ct. App. 1978).

With respect to the capitalization rate, the administrative judge finds that the appraisers' base rates ranged from 7.5% to 8.5% with Mr. Dawn's assumed rate actually being the higher one. The administrative judge finds that Mr. Dawn's somewhat higher rate should be adopted to reflect the future uncertainties enumerated in Mr. Humphreys' appraisal such as a declining population in the immediate area and the likelihood of increased vacancies. Given an effective tax rate of 2.04%, this results in a loaded capitalization rate of 10.54%.³

II. Sales Comparison Approach

A. Price Per Unit

The administrative judge finds that Mr. Humphreys' analysis should receive greater weight because the comparables were analyzed in greater detail.⁴ This reflects a value indication of \$30,000 per unit or \$8,400,000.

B. Effective Gross Income Multiplier (EGIM)

The administrative judge finds that Mr. Humphreys' analysis should receive greater weight because it was better substantiated. However, the administrative judge finds that an effective gross income of \$1,828,224 should be assumed based upon the direct capitalization discussion above. This results in a value indication of \$9,141,120 assuming an EGIM of 5.0.

III. Correlation and Final Estimate of Value

Based upon the foregoing, the administrative judge finds that the evidence supports the following indications of market value:

Direct Capitalization	\$9,348,615
Price Per Unit	\$8,400,000
EGIM	\$9,141,120

The administrative judge finds that the various indications of value should be correlated at \$9,200,000 with primary emphasis placed on the income approach.

IV. Deferred Maintenance

The final issue before the administrative judge concerns whether the adopted market value of \$9,200,000 should be reduced by \$1,200,000 as contended by Mr. Humphreys to account for deferred maintenance. According to Mr. Humphreys, the masonite siding is in poor condition and needs replacing. In addition, various miscellaneous repairs are needed.

The administrative judge finds that the only evidence in the record concerning deferred maintenance was the following statement in the addenda portion of the appraisal report:

³ The administrative judge finds that January 1, 2005 constitutes the relevant assessment date pursuant to Tenn. Code Ann. § 67-5-504(a). The administrative judge finds that at that point in time the assessor projected a 2.54% effective tax rate rather than the 2.04% rate ultimately adopted.

⁴ Moreover, the summary report introduced into evidence indicates that the comparables were adjusted in the complete report.

Estimated Cost to Cure Deferred Maintenance
Replacement of Exterior Siding (per contractors estimate)

	\$757,971
	<u>\$125,000</u>
	\$ 882,971
Repairs Allowance	<u>\$ 345,000</u>
Total Cost to Cure	\$1,227,971
Rounded	\$1,200,000

The administrative judge finds that the above-quoted information lacks probative value standing by itself. The administrative judge finds that the contractor was not present to testify and his/her estimate is not in the record. Similarly, it is unclear what repairs are needed and how the cost of the various repairs were calculated.

The administrative judge recognizes that additional evidence could very well support some or all of Mr. Humphreys' deductions. Absent such evidence, however, the administrative judge finds that the record presently contains insufficient evidence to establish what, if any, deduction should be made to account for deferred maintenance.

V. Sale of Subject

The taxpayer purchased subject property and another apartment complex on May 5, 2004 for \$20,100,000. The bulk of the purchase price was allocated to the other property because of the "rough condition" of subject property. The purchase price included a "kick-back" in the form of a sales commission of \$2,073,000 and a repair credit of \$345,000.

Respectfully, the administrative judge finds that a reliable conclusion of value cannot be ascertained from the foregoing. Accordingly, the administrative judge finds that the sale cannot receive any weight.

ORDER

It is therefore ORDERED that the following value and assessment be adopted for tax year 2005:

<u>LAND VALUE</u>	<u>IMPROVEMENT VALUE</u>	<u>TOTAL VALUE</u>	<u>ASSESSMENT</u>
\$560,000	\$8,640,000	\$9,200,000	\$3,680,000

It is FURTHER ORDERED that any applicable hearing costs be assessed pursuant to Tenn. Code Ann. § 67-5-1501(d) and State Board of Equalization Rule 0600-1-.17.

Pursuant to the Uniform Administrative Procedures Act, Tenn. Code Ann. §§ 4-5-301—325, Tenn. Code Ann. § 67-5-1501, and the Rules of Contested Case Procedure of the State Board of Equalization, the parties are advised of the following remedies:


1. A party may appeal this decision and order to the Assessment Appeals Commission pursuant to Tenn. Code Ann. § 67-5-1501 and Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization. Tennessee Code Annotated § 67-5-1501(c) provides that an appeal **"must be filed within**

thirty (30) days from the date the initial decision is sent.” Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization provides that the appeal be filed with the Executive Secretary of the State Board and that the appeal **“identify the allegedly erroneous finding(s) of fact and/or conclusion(s) of law in the initial order”**; or

2. A party may petition for reconsideration of this decision and order pursuant to Tenn. Code Ann. § 4-5-317 within fifteen (15) days of the entry of the order. The petition for reconsideration must state the specific grounds upon which relief is requested. The filing of a petition for reconsideration is not a prerequisite for seeking administrative or judicial review; or
3. A party may petition for a stay of effectiveness of this decision and order pursuant to Tenn. Code Ann. § 4-5-316 within seven (7) days of the entry of the order.

This order does not become final until an official certificate is issued by the Assessment Appeals Commission. Official certificates are normally issued seventy-five (75) days after the entry of the initial decision and order if no party has appealed.

ENTERED this 17th day of May, 2006.



MARK J. MINSKY
ADMINISTRATIVE JUDGE
TENNESSEE DEPARTMENT OF STATE
ADMINISTRATIVE PROCEDURES DIVISION

c: Mr. Walter H. Benedict, Jr.
Bill Bennett, Assessor of Property